Lithuanian Free Market Institute

Facts and analysis

INTEGRATED EUROPEAN MARKET FOR CARD, INTERNET AND MOBILE PAYMENTS

Summary

Commission claims that the current payment landscape is actually hindering the development of new payment methods, e-commerce, competition and development of Single Market in general. Thus it chooses to promote regulation on various levels. According to the Commission the most important reason for regulation is the fact that Interchange Fee (IF) is the culprit of the current market situation: it is allegedly too high, varies across countries and is not transparent. Such fee is a result of a two-sided market (four-party system), where consumers and merchants have to bear certain costs, so that card and other payment forms could be used easily by both parties. Unfortunately, Commission does not consider the actual evidence of IF regulations from Australia and Spain, where consumers faced increased card fees and there were no compelling evidence of reduced prices on the part of merchants. In addition, Commission is proposing additional commerce regulation. It seeks to engage in deciding what brands should be on payment cards and whether there could be several of them, and steering consumers towards choosing payment methods "optimal for society". It also seeks to influence the level of vertical integration among companies (card schemes owning payment processing companies); standardization of IT protocols, payment method processes and cards themselves, and global interoperability and security of payments. The most striking thing is that it fails to recognize the current development level of markets, investment and innovation done by market actors and actual growth of e-commerce. Commission mentions in the Green Paper, that according to their consultation paper results, finding investment for new or developing companies is more cumbersome, than regulation of IF or any of the related issues in the Green Paper.

There is no evidence that regulation of IFs would lead to reduced prices for consumers.

Regulation of IF could lead to less competition and innovation.

Harmonization of IFs and additional regulations could negatively affect EU competitiveness.

Introduction

It is necessary to promote and ensure the principle of the European Single Market that benefits all European citizens and especially in the case of the growing digital economy that brings potential for every party involved. LFMI agrees with the EC statement that "***Secure, efficient, competitive and innovative electronic payments are crucial if consumers, retailers and companies are to enjoy the full benefits of the Single Market, and increasingly so as the world moves beyond bricks-and-mortar trade towards e-commerce***"[1].

However LFMI cannot agree with the proposed way of reaching these goals as proposed in the EC's Green Paper. An objection immediately arises regarding the milestone of Single Euro Payment Area (SEPA) which is based on the fact that "***there should be no distinction between cross-border and domestic electronic retail payments in euro across EU***" and that the SEPA could be passed on to non-euro denominated transactions and operations. We can immediately raise a question whether the current market conditions represent the sort of irregularities, monopoly environment, underdevelopment or market failure that would justify an intervention of this scale. The Green Paper does not provide enough evidence of the payment landscape being underdeveloped, non-functioning, lacking innovation, consumer choice or transparency.

Current market conditions and organization of the system

There were about 58 billion retail payment transactions conducted across euro area in 2009 according to European Central Bank (ECB). According to some studies (claim by the Commission) about 300 billion EUR worth of direct and indirect benefits over 6 years could be extracted if the whole payment landscape of credit transfers, direct debit and payment cards migrated to SEPA[2].

Payment cards

According to ECB there was a 4.6% increase in non-cash payment instrument usage in 2011 reaching 90.6 billion. The share of payment card based transactions was 41% of the total amount, with the total number of cards in EU being 727 million or 1.44 cards per capita. Overall value of such transactions was 1.9 trillion EUR or 52 EUR per transaction[3].

Internet payments (e-payments)

Growing e-commerce due to improved internet capabilities and cheaper transactions both for customer and merchant had seen an increase of volume over the years. This is especially useful for merchants because of decreased costs, less need to own or rent a shop or other facilities, faster access to larger markets and the ability to sell goods and service across the globe. According to Ecommerce Europe[4] the market of e-commerce in Europe grew by 19% in 2012 reaching a volume of 311.6 billion EUR in B2C segment. In 2010 Europe surpassed USA as the biggest business to consumer (B2C) market in the world and now has 35.1% share of the global B2C market, where the USA and Canada has 33.1% share and Asia-Pacific has 25.6% while being most rapidly growing region. Furthermore Ecommerce Europe expects the volume of the European B2C market to reach 625 billion EUR in 2016, more than double in the 4 year period or a 25% growth annually.

This is a very positive trend and in order to be in the lead, Europe has to adopt such decisions that do not impede growth and innovation for e-commerce through excessive regulations. The current share of e-commerce in Europe is only 3.4% of total retail trade[5], however as seen from prior evidence it is clear, that it is growing. The trend is positive for increasing the share of e-commerce in retail trade, without government intervention.

Green Paper states that one of the main obstacles for development of e-commerce is payments as noted in

[1]Green Paper, page 2
[2]Green Paper, page 3
[3]http://www.ecb.int/press/pr/date/2012/html/pr120910.en.html
[4]http://www.ecommerce-europe.eu/press/2013/05/press-release-european-e-commerce-to-reach-312-billion-in-2012-19-growth
[5]Euromonitor, 2010

the consultation paper[6], but the consultation paper has a contradictory statement: "There was no general consensus on whether the payment problems exist. 57% of consumer associations and many businesses agreed that problems do exist, but 11% of private individuals and some industry federations stated the opposite". Green Paper fails to mention the fact that in the consultation paper done by the Commission the difficulty of financing e-commerce is heavily stressed and seen as a bigger problem by businesses and business associations than the regulation of IFs. According to respondents it is hard to find investors and venture capital in EU that is willing to participate in such businesses under these current economic conditions. Moreover it is difficult to determine the true value of such startup businesses.

„Difficulty of financing a business is seen as a bigger problem, whereas IF is a secondary issue".

The variation of different payment integration systems in Europe across different payment instruments is seen as a market failure. One also has to have in mind that this market is in its infancy. Also the market differences can be accounted for by other factors such as the differences in the level of development of a particular country (e.g. technological, regulatory, taxation and etc.).

Mobile payments (m-payments)

M-payments are the newest of all payments thus having a lot of untapped potential. According to the same Ecommerce Europe, 47.6% of Europeans have a smartphone. As stated in the Green Paper, according to Juniper Research[7] it is estimated that the value of m-payments in 2010-2012 should increase from 100 billion USD to 200 billion USD across the World. Yet, when EC provides numbers from other studies regarding m-payments it provides estimates that in 2014 it should reach 1 Trillion USD and 350 billion USD would be European, but no sources are provided to analyze such claims.

According to the EC the lack of m-payments penetration and small numbers of actual m-payment users 7.1 million in 2010 compared to 62.8 million in Asia/Pacific naturally presumes a need to regulate and "build" such market due to fragmentation and that key actors in such market have not yet agreed on the business model that enables such payment solutions. More importantly EC[8] sees Google, Apple or Visa in negative light for their approach of launching new innovative solutions from "outside Europe". Because EU is a part of Global economy, there is no difference between who is providing goods or services to Europeans as long as the price and quality is accepted by Europeans.

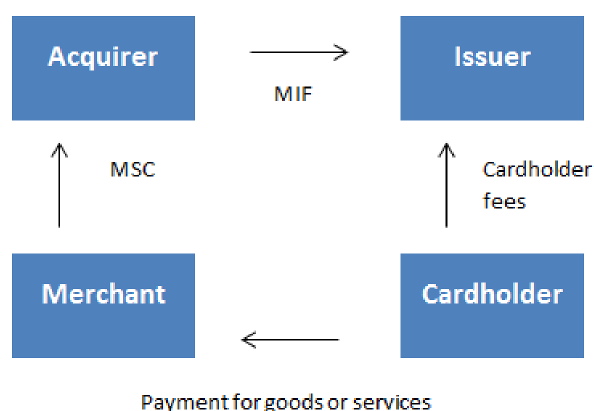
The four-party system

The four-party system is based on participation of 4 agents and their transactions among each other:

- Cardholder or consumer
- Cardholder's bank (issuing bank)
- Merchant
- Merchant's bank (acquiring bank)

The typical scenario is as follows. (1) Cardholder (consumer) goes and takes out a payment card (debit, credit) from his/her (2) bank (issuing bank) for a certain periodical or a yearly fixed fee to the bank. The consumer goes to buy goods or services (not only in physical terms) to a (3) merchant which in turn uses its own bank, known as the (4) acquiring bank. The consumer pays for a good or service with the help of a card, the merchant sends a request to his bank (everything is done electronically) to request money from the consumers bank for the goods or services sold. Now all of the disputes come from now on. There is a fee which is being paid by the merchant for the operation between the banks and it is known as the Multilateral-interchange fee (MIF) (it is a part of Merchant Service Charge (MSC) paid by merchant to acquiring bank for all service (i.e. a bundle of fees) and will be referred as Interchange Fee (IF).

[6] http://ec.europa.eu/internal_market/consultations/docs/2010/e-commerce/summary_report_en.pdf
[7] Green Paper, page 5
[8] Green Paper, page 6



What is Multilateral-Interchange fee?

Multilateral-interchange fee (MIF) is a bank to bank (or other non-bank institution) payment for the ability to use cards and receive benefits of it (card based transactions), originally paid by merchant to its own bank in a form of Merchant Service Charge (MSC) in which the interchange fee is included. This fee is an important part of this so called four party system. This fee helps to create a platform for two parties to participate in. And this participation is based on the understanding that either side, has to use and accept (in this case) cards, in order for this market to function properly. Based on that merchant and cardholder have a common interest, thus they have to pay a certain fee (costs) for such market to exist. When consumers want to take out a card they go to their bank and take the card out, for a set fee. Merchants instead pay a small amount from each transaction when a card is being used.

If the issuing bank did not charge the merchant this interchange fee, it would try to cover its costs of issuing cards (e.g. making the cards, transporting them, payment guarantee for merchants in case of fraud or cardholder default, immediate settlement for merchants, innovation in new products and new security features) in other ways such as charging higher fees to the cardholder, reducing discounts, benefits, and interest free payment periods. In turn merchants could enjoy increased number of sales/profit, because typically card holders spend more and there is less risk of cash related problems (robberies, employee theft, transporting the cash to the bank, counting them, fake money) and easier accounting.

Comparison of IFs in Lithuania, Latvia, Estonia and Poland

According to statistics of interchange fees provided by ECB [9], in 2010 in Lithuania domestic debit card transactions were either set by bilateral agreement or set by Visa from 0.9% to 1.5% and for international transactions from 0.15% +0.015 EUR to 0.19% + 0.015 EUR. Whereas rates for domestic and international transactions for credit cards were as well either agreed bilaterally or from 0.9% to 1.5% or from 0.5% to 0.75%. Respectively MasterCard set their rates for domestic debit card transactions from 0.4% + 0.05 EUR to 1.05% + 0.05 EUR or by bilateral agreement. For international transactions the rates were from 0.1% + 0.05 EUR to 0.13% + 0.05 EUR. For international transactions credit card rates were from 0.14% + 0.05 EUR to 0.18% + 0.05 EUR.

In Latvia, only domestic rates were provided for both Visa and MasterCard and they were the same. Debit card rates were from 0.5% to 0.6% or bilateral agreement between banks. Credit card rates were from 0.85% to 1% or bilateral agreements between banks. In the case of Poland, only interchange rates for international transactions are provided. MasterCard rate for debit card was 1.6% and for credit card 1.45%. Visa for debit card set 1.45% + 0.05 EUR and for credit card 1.5%. ECB does not provide data regarding interchanges rates for Estonia.

As of now (2013), the current interchange fee rates for consumer cards set by Visa for Lithuania are from 0.9% to 1.5% for debit cards and from 0.9 to 1.5% for credit cards[10]. Meanwhile for Latvia it is from 0.15% + 0.025 EUR to 0.19% + 0.015 EUR for debit cards and from 0.5% to 0.75% for credit cards. In Estonia the rate is 1% for both debit and credit cards.

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[9] http://www.ecb.europa.eu/pub/pdf/scpops/ecbocp131.pdf
[10] http://www.visaeurope.com/en/about_us/our_business/fees_and_interchange.aspx

In Poland the rate for debit cards varies form 0.9% to 1.9% and for credit card from 1% to 1.6%. In the case of MasterCard[11] interchange rates for Lithuania, for consumer debit cards varies from 0.85% to 1.35% and for credit card from 1.30% to 2.05%. In Latvia the rates for consumer debit cards are from 0.4% to 1.13% and for credit card from 0.6% to 1.83%. Rates set for debit cards in Estonia are from 0.45% to 0.95% and credit card from 0.9% to 1.65%. For consumers in Poland rates for debit cards are from 1% + 0.03 EUR/0.04 EUR to 1.6% and for credit cards it is from 1.9% to 2.40%.

Problems seen by EC and the proposals

The Commission suggests five potential[12] issues that need to be dealt with to achieve goals of an integrated market. The first issue is related to market fragmentation, market access and cross-border market entry. The second issue is related to transparent and cost-effective pricing of payment services for consumers, retailers and other businesses. The third issue is related to standardization or the lack of it. The fourth issue is related to greater cooperation that leads to greater interoperability and the fifth way or issue is related to ensuring security of payments. LFMI analyzes each issue with a subset of problems as perceived by the Commission in the Green Paper and provide arguments on the proposed solutions to these problems.

Issue 1. Market fragmentation, market access and market entry cross-border.

Problem 1 - Multilateral-interchange fees (IF)

According to the Green Paper[13] "The existence of a wide variety of different (levels of) fees and the different timelines and scope of legal proceedings under way or completed at national and European level could lead to distortions in the Single Market. This could exacerbate market fragmentation, and means that retailers cannot yet enjoy the benefits of a Single Market in payment cards." In addition EC presumes that IFs "may act as entry barriers to low-cost card schemes and other payment systems." Also that "The problems of high IFs and a lack of transparency appear to be particularly relevant to merchants accepting commercial cards — i.e. payment cards issued to companies and their employees in order to allow them to pay for work-related expenses (e.g. business trips, office supplies) — under which card holders may be

[11] http://www.mastercard.com/us/company/en/whatwedo/interchange/Country.html
[12] Green Paper, page 7
[13] Green Paper, page 8

Examples from Australia and Spain

EC is not the first one to address the issues regarding multilateral-interchange fees, and actually has been raising the question whether they should be regulated or not for a long time (Since 2003). Yet there are several countries like Australia or Spain that already have intervened in this field. In both cases the main reasons were the same: supposedly IFs were too high and non-transparent.

According to a report by CRA International [1] the reduction of interchange fees in Australia from 2001 to 2004 had actually harmed consumers by a 22% increase of standard cardholder's fees and 47-77% increased fees for premium cards. It is estimated that Australians are paying additional 480 million AU for card fees each year. Furthermore the CRA report establishes that the claims of "undeniable losses" for consumers by Reserve Bank of Australia were not proven and were not offset by reduced prices for consumers. Each year merchants have saved about 850 million AU without undeniable proof that this had led to reduced prices.

This as well had an impact on innovation and competition, since it became more difficult to enter such market and there was less incentive to invest into technology. A more recent study of Spain's intervention into multilateral-interchange fees has shown that this intervention is not providing the results that everyone had wished for. The period from 2006 to 2010 saw a 57.3% reduction in interchange fees. The 3.329 billion EUR reduced income by card issuers had to be and were compensated by a 50% increase of cardholder's fees over the period and costing consumers 2.350 billion EUR in absolute numbers.

More importantly, there were additional fees for overdrafts, consumers saw reduced rewards and promotions. As in the case of Australia, the Spanish merchants had seen a reduction of Merchant Service Charges (MSC), which allowed saving them 2.749 billion EUR in the period mentioned. However no evidence of reduced prices was provided by merchants nor by the Spanish government institutions, which enforced such measures. This affected the four-party system in a way that it became more difficult to compete with a three-party system, decreased competition and innovation.

incentivized with bonuses and other advantages to make use of this means of payment."

The differences of multilateral-interchange fees across Europe are easily justifiable by simple understanding, that there are in each and every country different prevailing market conditions, which determine the development level and the rate of IFs. In order to develop electronic payment methods a certain fee has to be charged. Countries that have more payment cards, higher value per payment transaction and more payment transactions usually have lower IFs, because it becomes less costly to improve and develop payment methods. Whereas countries that seek to improve the limited use of electronic payments and develop cards market have higher IFs in order to have the funds for the development and innovation. Moreover the regulatory environment of a particular country is an additional factor responsible for differences in IFs.

The presumption of EC that low-cost card schemes may be prevented from participating in the market is not grounded in any way. If the new card scheme were better, even in the case of high IF there would be little problem to offer such services, because it already has a competitive advantage in terms of being low cost. To add, it is very strange, that EC stresses a problem with commercial cards, but instead of directly dealing with it, it tries to introduce broad market regulation, that do not benefit any party involved.

The proposal by the EC to impose price controls (regulating IFs) is against the fundamental principal of competition promotion and free setting of prices by market actors.

Problem 2. Cross-border acquiring

Cross-border acquiring (CBA) occurs when the merchant is using services not from a native (the same country as the merchant) but foreign Payment Services Provider (PSP). According to EC the current situation is problematic for the development of cross-border acquiring[14]:

- *"International card schemes apply special authorization regimes and special scheme fees/license fees to acquirers offering cross-border services."*
- *"Cross-border acquirers must pay issuing PSPs the domestic IF applicable in the country of the point of sale. This prevents merchants from shopping for the cheapest acquirer, although the cross-border PSP has typically not signed up to the domestic IF concerned, which is set by the PSPs in the country concerned."*
- *"Cross-border acquirers may also be at a disadvantage in countries where domestic PSPs have parallel networks of bilateral interchange fee agreements. This impedes the development of cross-border competition as acquirers have to pay the official full IF amount."*

The current situation for domestic transactions is the following; bilateral agreements regarding the level of the IF can be decided by central acquirer with multiple numbers of issuers, if not the domestic interchange fee is applied. If there is no domestic IF, an international one is applied. In the case of cross-border central acquiring, once again the acquirer can agree on bilateral terms with issuers. If not, then the international IF is applied.

Even if there are any technical obstacles for the development of central acquiring, such issues are not impeding the growing number of central acquirers. However, it is vital for a card scheme to have scheme fees for the central acquirers, because there is risk associated with it and damage which can be made by incompetent behavior. It is important to check (due diligence process) and have some sort of a guarantee that the acquirer will deliver services of acceptable quality to customers. EU has to be careful of regulating what and how the card schemes have to accept as potential acquirers which are capable of delivering services to merchants.

Problem 3. Co-badging

Co-badging is a situation when there would be/are several brands on the payment card or a card-reading device. EC sees co-badging as more choice for consumers, more opportunities for new market entrants and that current restriction by existing schemes might prevent competition in national markets for other brands that could be on the same card.

EC is not entirely correct. There are cards that carry several brands[15] for domestic and international market. The domestic brand is suited only for the domestic market; whereas the international brand allows the cardholder to use it abroad (Bancontact/MisterCash-

[14] Green Paper, page 9

[15] Comments by MasterCard Incorporated, MasterCard International Incorporated and MasterCard Europe SPRL on European Commission's Green Paper "Toward an Integrated European Market for Card, Internet and Mobile Payments", page 40.

Maestro). Another example would be Girocard, used in Germany. Additionally there are examples of companies using a third brand (interbank network), to unite their various brands (e.g. Cyrrus for brands of Mastercard, or Visa Plus for VISA).

We should not forget that various brands are associated with intellectual property and vast sums have been spent on their image. In fact certain brands are associated with luxury, style and choice, and their consumers would not want to have a co-badged card. Lastly and most crucially there is no supporting evidence (or at least it is not provided by the Commission) that there is a sufficient demand for co-badging).

Finally, at least 7 other issues occur, that would have to be dealt with if co-badging were introduced by regulation:

- Several brands can affect the time spent at the cash register, by prolonging the time to conduct the operation. It could mean higher fees for the card holders.
- Different brands have varying technologies and IT protocols, thus implementing them would require additional resources.
- Which and how many brands would be chosen to reside on the payment card? This could be competition restricting practice if EC chose which companies were placed on the payment card.
- With two brands one has to have priority or to be the default one to allow payments. Does the consumer decide which brand is the dominant one?
- When to allow the selection of the payment method? When receiving the card from the issuer or at the cash register each time the transaction is made? Additionally the cash register has to have an option of selecting the payment method or brand.
- In case of fraud or theft a brand has to be liable with the issuing bank. Yet, how to achieve this?
- In case of bad costumer experience which brand is the liable one?

It is quite possible that co-badging would create many problems and resolve very few (if any).

Problem 4. Payment processing by subsidiaries

Claims are made by EC that some companies of cards own a subsidiary that manage the payment process. This is seen as a market entry barrier to other payment processing companies and card schemes[16]. Thus these two (card scheme management and card payment processing) should be separated to promote competition. EC sees a potential opportunity to solve this problem by developing and independent processing standards applicable to all market actors.

This is a case of vertical integration and trust between companies which are working in this sector. Costs of entering the market are so important that having a subsidiary are less important in comparison. These are natural barriers to enter the market. Companies have built reputation by being good and efficient service providers, made investments in order to develop such services. More so artificial separation of parent companies and subsidiaries would increase operational costs which would translate into more expensive services. In the same time, one can ask whether regulation of IF would decrease the said barriers (unless one assumes that "regulation" means "reduction", but once again such assertion would be premature).

It is doubtful that separating card schemes and payment processing companies would improve efficiency and innovation in the market. Furthermore it may reduce schemes for risk sharing and, in fact, make the entrance for possible entrants even more difficult, if new entrants would be prohibited to own a payment processing company (or be owned by payment processing company).

Problem 5. Access to settlement systems

Institutions that are not banks have to use other banks and investment firms in order to access clearing and settlement systems. Thus non-bank PSP has more difficulty in competing with banks, since they must use banks to settle payments.

In fact this system has been created by previous regulation (98/26/EC Settlement Finality Directive (, Article 2(b)) on payment services in the internal market (PSD), which is based on the financial institutions being approved of participating in settlement systems. It is obvious that the Commission has created such conditions that Directive 2007/64/EC on payment services has opposing statements towards statements

[16] Green Paper, page 10

in the Directive 98/26/EC. Forcing to make settlement access easier to anyone increases risk of losing important information and creating loss to financial institutions or account holders. In principal these directives are opposing one another and changes should be made if SEPA is to be achieved, but not forcing market actors to take intolerable risk and without jeopardizing consumers.

Problem 6. Compliance with the SEPA Cards Framework (SCF)[17]

The impact of SCF is wider than payments in euro area, because non-euro PSPs and card schemes, which in order to be able to deal with euro transactions have to be compliant to SCF. But the SCF in itself has a plan to eventually phase out non SEPA compliant schemes out of the market. These requirements set rules and requirements under which cards must be SEPA compliant by issuing PSP.

There are three frameworks that lay down the rules for SEPA card processing; SCF (SEPA Cards Framework) – it means that scheme/brands and processing cannot be offered in a bundle, SCS (SEPA Cards Standardization) – it has various requirements which processors must comply with in order to be SEPA compliant and ISO standardization for ISO 8583 Financial transaction card originated messages" and ISO 20022 "Universal financial industry message scheme".

EC sees this limitation on business as a positive thing, because those systems that are allowed to "live" would be operating in a single integrated market. The desire to create the SEPA and to follow SCF cannot overlook that fact, that there are market participants (PSP), which are successfully providing services in the market, by improving competition, efficiency, innovation and ultimately are serving consumers. If the current PSPs and card schemes that are non-euro, but are providing services and are SCF compliant, would not be allowed anymore, this would mean less market competition and some sort of protectionist measures by EC for the euro area PSPs.

This is clearly a departure from a regulation intended to "fix" "market failures". It seems that the Commission is engaged in "mission creep" and tries to introduce its own standard by limiting competition instead of promoting it.

Problem 7. Information of availability of funds

Since banks are responsible for bank accounts and related information, they might limit or totally refuse to provide information to other PSPs. EC thinks that banks might not cooperate even if consumers allow their information related to accounts to be disclosed.

Since banks or other financial institutions are responsible for the account and fraud prevention, it is in their self-interest to protect information regarding the account holder and his/her account information, from being misused. The more there are parties which are involved in accessing information the greater the chance of losing (leaking) such information or theft. No special privileges should be given to either side; it should be left for the parties to agree between them.

Problem 8. Dependence on payment card transactions

Green Paper questions if there are merchants completely dependent on payment by cards and ability to accept them. And in addition EC asks if there is a need for clear and objective rules stating when payment schemes may unilaterally refuse acceptance.

There are a lot of cases where companies are dependent on other companies. Dependency is not a sign of market failure. It is very likely, that based upon the current system of payment methods, merchant has made a thoughtful decision to base his payment services on payment cards, due to significantly lower costs of operations. Dependency does not call for regulation. Those who are more dependent, most likely derive most benefit from the ability to accept cards. For example, without this service e-commerce would hardly exist. And actually merchants are not that dependent on cards since they can opt for many other payment solutions such as electronic transfers, direct debits, cash at delivery, etc. They prefer cards because they offer them security, convenience and flexibility that their consumers want.

[17] Green Paper, page 11

Issue 2. Transparent and cost-effective pricing of payment services for consumers, retailers and other businesses. Are merchants and customers fully aware of the actual costs? Does it even matter?

Problem 1. "Consumer – merchant relationship: transparency"[18]

According to the Green Paper, consumers are not aware of costs for specific payment instruments they or merchants pay. EC claims that consumer choice regarding the payment method might not be optimal in terms of costs to economy. According to them merchant would eventually include all real costs into the final price, thus consumers would be paying more for goods and services. One way to promote better choice by consumers would be informing them how much a particular payment method costs to the merchant. This should lead to more transparency.

Commission presumes that consumer would act in a different way if informed about the payment costs for merchants. Neither consumers, nor merchants have an obvious reason to know or try to figure out the actual costs associated with different payment methods. Consumers might not be interested in what costs are borne by merchants, but they are interested in the final price. Additionally merchants could be not willing to disclose the costs for a number of reasons.

There are multiple and overwhelming pieces of evidence of markets functioning perfectly, without consumers even being aware of the components of costs. From iPhones to cars to electricity bills.

Problem 2. Consumer – merchant relationship: rebates, surcharging and other steering practices

Green Paper suggests that in order to promote transparency and efficient payment instruments merchants could be given additional powers in promoting one or another kind of payment instruments by selective card acceptance, surcharging, indicating preferred means of payment and etc. According to Green Paper: "In accordance with the 'user pays' principle, costs should in principal be borne by those who use a specific service and not distributed between wider groups.", Merchants can already apply certain measures for steering consumers.

Merchants already have the ability to use rebates, surcharging and steering practices in order create incentives for the consumer to use one payment method or the other. Consumer based upon this information can choose the payment method that fits best. Or to find another merchant if the current does not satisfy the needs. For example a merchant who does not have an American express or Visa reader is already steering the consumer. More so the merchant can completely refuse to accept certain cards at the cash register or provide information on the doors or elsewhere in the shop regarding the possible payment options. No harmonization across EU should be pursed at all, because the decision done by the merchant to use steering practices is completely an individual decision. Given the possibilities, it is not clear why or how harmonization is a right policy. Moreover, this has not connection to the regulation of IFs.

Problem 3. Merchant – payment service provider relationship

EC sees a potential in improving transparency in pricing of payment instruments, by tackling the tree rules set by card schemes, so that merchants could more easily influence consumers and would not be limited to choose what cards to accept. According to Green Paper this creates an environment for high IFs by PSPs, eventually reducing competition:

- *"No Discrimination Rule (NDR), under which retailers are prohibited from directing their customers towards the use of the payment instrument they prefer through surcharging, offering rebates or other forms of steering."*
- *"Honor All Cards (HAC) Rule, under which merchants are obliged to accept all cards within the same brand, even if the fees related to them are not the same."*
- *"Blending practices, applied by card acquirers. As a result of blending only an average fee for card payments is charged to merchants by their acquirers and the merchant is not informed about the MSCs applied for the various individual categories of cards."*

Empowering merchants[19] to negotiate with acquiring PSPs, for MSC, by changing card scheme rules and practices of acquirers would improve merchant's ability to steer the consumer. And according to the EC this could lead to smaller costs of payment cards to the economy and would promote competition and a chance of new schemes getting accepted by merchants.

First of all Commission fails to recognize that IFs in most cases are set by card schemes like MasterCard or Visa, but not by PSPs. Second, the NDR has already been abolished in some cases. Even more, some card schemes have rules that allow merchants to use surcharging, offering rebates and steering practices. Thirdly, regarding the issue of HAC it would be a loss to consumer not to have such a rule, since a card owner within the same brand, but with a different card than

[18] Green paper, page 12

[19] Green paper, page 13

another consumer might be prevented from using it when buying goods or services.

This is related to the fact, that a particular brand regardless of whether it is a different card within the same brand is usable and recognized anywhere and everywhere. This means more incentives for consumers to use cards, because they are accepted by a lot of merchants. As for the blending situation, merchants can ask acquirers to untie all MSC categories, so that it could be seen, what cards have what IF rates, and then decisions can be made upon this information, as to what steering practices can be made or what payment methods can be accepted. It is not clear how consumers would eventually benefit from these proposed changes. More importantly, is this matter of surcharging, rebating and steering is of vital importance and does it create real, actual problems?

Issue 3. Standardization (or lack of it).

According to Green Paper cross-border interoperability has to be achieved to ensure that European payment users (merchants, companies, and consumers) can enjoy benefits of competition, freedom to choose, more efficient payment operations standardization applicable to all actors involved and payment instruments. Yet, standardization process has certain risks of reducing competition or innovation by driving out companies out of the market.

Problem 1. Card payments

There are transactions between (PSP) acquiring bank and issuing bank (A2I domain) and between merchant and acquiring PSPs (T2A domain). There are several problems with the second form of transactions (T2A). Green Paper stresses that only private initiatives are in development that deal with technical specifications (EPAS and C-TAP) and cross-border standards. That they are on diverging paths, thus having consequences that[20] *(1) "lack of common standards limits the range of potential service providers to domestic acquiring PSPs and therefore hampers the achievement of a competitive Single Market for payment services", (2) "merchants have to maintain different systems and protocols for managing data exchange in the acquiring process — at least one for each country they operate in, but in many cases even more, thereby reducing the opportunities to centralize operations and limiting efficiency gains" and (3) "the lack of common standards in the T2A domain often prevents debit cards from being accepted abroad — a consumer experience which is not in line with the Single Market and a common currency for cash payments in the Member States of the euro area". A2I domain as well lacks standardization and is facing similar problems.*

[20]Green paper, page 15

Common standards for cards are useful, but the best common standards are developed in the market under competition forces in play and market actor's decisions to invest in such standardization. Pushing one standard does not lead to more competition or creation of a single market. Single market instead is pro-different products that exist and are following the very basic and essential standards needed to operate in the market.

Lack of ability to use debit cards abroad limits the Single market no more than the existence of different currencies within the EU. Moreover consumers who feel inconvenienced can opt to use credit cards or credit – debit combinations widely available on the market, e.g. Visa Electron – VISA, Maestro – MasterCard etc.

More importantly market standardization allows existing different products to participate, but they are not that far from the standard, or else they would not be recognized and accepted by market actors. To add, the current ISO (8583) standardization is significant in ensuring the common features of a product and allows significant but not too much variations and is implemented by market actors. Developing very European oriented standardization as for A21 or T2A poses problems for global compatibility for cards.

Problem 2. E- and m-payments

EC sees that such type of payments instruments is not really ready to be fully working across borders and that ecosystem of coherent business models for m-payments is not developed yet. Even though there is a mention that gaps exist, the Green Paper is not specific. It is stressed that inter-operability between m-payment solutions should come from standardization which leads to enabled consumer mobility. Green Paper addresses that fact that e-payments done by the internet eventually are carried out via internet banking or as card payments. According to EC this is a negative impact on parties that are involved in this payment chain. However, it is not clear how to achieve ease for consumers to access e- and m-payment solutions and that such platforms are user-friendly, and all of that is ensured by standardization.

There is no need to impose standardization neither on e-payments nor on m-payments, because these are rapidly developing new markets and the future of commerce is depending on it, thus if the EC seeks to develop such markets and truly establish a Single Market, it has to step down and let market innovation to take place, develop new services and products and maybe even payment methods. This e-commerce in

general is probably the best and only chance for EU to establish a Single Market with the help of internet and internet technologies.

Issue 4. Need to improve cooperation in order to achieve greater interoperability.

Problem 1. Interoperability in the domain of m-payments

In the view of EC the problems for the development of m-payments[21] are related to Mobile Networks Operator (MNO), PSPs and other players, because as according to the Commission MNO wish to retain control as being security service managers in such business. Another problem is that market actors are developing standards, which determine interoperability and dominate the payment chain: devices, applications and security management. High chance of fragmentation of the market, because there are important sectors, that should not be left alone to deal with interoperability without addressing standardization as the main driver.

Even though m-payments are not that spread out for consumers to use, but the standards are developed by market participants who at first have to be willing even to participate, because standards are a result of competition, investment and innovation. Any intervention may have a negative impact on the development on such market, and eventually would lead to less competition, innovation and most importantly consumer choice and satisfaction.

Problem 2. Interoperability in the domain of e-payments

Currently there are several bank-based schemes which are trying to test their proposed systems for interoperability. No data about which system is better.

The same solutions apply as with the interoperability of m-payments to e-payments.

Problem 3. Interoperability and competition

EC proposes distinction between commercial and technical interoperability, for merchants being able to choose acquirers and consumers being able to choose issuers irrespective of their location. EC also stresses the challenges of interoperability in three party systems but does not elaborate more on that issue.

LFMI would strongly advise EU not to develop EU specific interoperability standards, because this could lead to consumers outside EU being unable to use global brand cards, due to different interoperability requirements and also Europeans going outside Europe would face difficulties paying with cards of a global brand, if it is different from the rest of cards across the globe. More so, it is too early to say, how the interoperability should look, because m and e-payments are being developed and natural interoperability standards will emerge under the market conditions.

Issue 5. Security of payments.

The Commission identifies security of payments as one of the reasons of the small spread of electronic commerce.

Problem 1. Security vs. speed

Improvements in fraud prevention like improved card technologies and compliance to EMW (Chip and Pin) had reduced the numbers of fraud significantly. In 2010 90% of POS card terminals and 80% of all payment cards were EMW compliant in the EU. According to Green Paper such activities are moving to payments over the internet. "Remote card transactions represent only a minor share of all card transactions but already account for the majority of all fraud cases"[22]. Non-card e-payments are at risk as well. Potential solutions by EC are a two-factor authentication. To use a PIN code and a one-time random code obtained by SMS or other device (token device). What to choose: security or speed and ease?

In general, companies invest a lot into security and innovation to prevent fraud and improve consumer satisfactions. More importantly, because of the rapid development of internet technologies and spread of e-commerce, this problem of security of payments or of particular remote card transactions is moving towards digital payment methods (traditional payment methods are secure). This is a global phenomenon and brands need to apply universal security measures not only specific ones (EU) in order to ensure full scope of services, security, satisfaction for consumers, operability and acceptance anywhere and everywhere. Commission should realize the fact that the fraud prevention is an everyday challenge, and thinking that setting certain rules and procedures, would from now prevent fraudulent activities in the future is unrealistic. This is a wishful thinking on Commission's part. To add, the rapid spread of e-commerce indicates, that at least for now security of payments is not the most contributing factor that hinders e-commerce growth and development of e and m-payments. Currently the market is managing to strike a balance between

[21] Green paper, page 17

[22] Green paper, page 18

security measures and consumer satisfaction of using a particular payment method.

Problem 2. Data protection

Green Paper stresses that data protection is a very important matter and that all parties involved in payment operations have to follow the framework lay down by 95/46/EC and 2002/58/EC directives. According to them the numbers of parties involved have to be only the necessary ones which have access to data authentication.

This is an interest of a company to make sure that consumer data, identity or other related information is protected from third parties, which do not need to be involved in the process. If a company were not ensuring security, consumers would not choose to use services of such company. Current security protocols (e.g. PCI DSS) and standards are a sufficient means of security. More so, there are numbers of governing bodies that require proof of sufficient security measures taken by a company, third party audit and many more measures that check the level of processes that are in place to protect information.

Conclusions and proposals

- The general line of the Commission's view is that current market conditions are unsatisfactory, yet evidence of rapid growth of innovation, retail trade volumes, new market participants and new payment methods, provide a different picture.

- Commission does not acknowledge the fact that IFs are a bridge between merchants and consumers to operate and to develop payment methods. The issues identified by EC as problematic and thus requiring intervention are actual attributes of the complex market.

- Different IF levels across countries are a representation of different two-sided market development level, regulatory environment and economic conditions.

- EU should not go on the path of establishing any new agency to promote or to regulate IFs, standardization.

- Markets develop on their own. Entrepreneurs and investors who accept risk, but force no one to acquire goods and services from them, experience both profit and bear the loss, whereas in the case of regulating the market, consumers are paying twice. Once for the regulatory agencies that push an agenda of regulation on a particular thing or a set of things, and the second time, when a new regulatory body is created to prevent market irregularities which actually had been caused by the actions of other regulatory bodies.

- Competition and innovation are the two actual ways of ensuring market development and consumer welfare by providing better, cheaper goods or services. One important understanding has to be made by the Commission, which is that the market is not a stationary thing it is not an actual place. Instead, this is a process, thus thinking if a regulation is in place, and that it solves a problem from now on is a misleading preconception. The best thing for Commission is not to intervene into the market or at least ensure the opportunity for everyone to start and develop a business. Starting business, running it (compliance to the vast number of regulatory agencies) and most importantly finding or ensuring investment for new or developing businesses is more problematic and should be on the top of to do list, instead of picking at the tool that actually had been developed by the market.

- Surprisingly Commission fails to recognize the actual findings of IF regulations from Australia and Spain and is following in the same foot steps to reduce competition, freedom to start a

business, consumer choice, which are the very things that it has to safeguard as written in the Treaties of EU.

- The regulation of interchange fees leads to more harm than good to both consumers and merchants. It hinders growth of card, internet and mobile payments. Reduction of IFs would lead to increases in other fees that consumers pay. In the same time there is no evidence, empiric or theoretical, that reductions of IFs would lead to reductions of the final prices for consumers.

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